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NON-PAYMENT OF RENT DUE TO THE CORONA PANDEMIC - LEGALLY AND ETHICALLY JUSTIFIABLE?

Tim Drygala

AUTHOR

Prof. Dr. Tim Drygala holds the Chair for Civil Law, Commercial and Company Law at the University of Leipzig.

ABSTRACT

The announcement by Adidas, Deichmann and H&M to stop paying rent for their closed shops beginning in April has caused quite a stir. Tim Drygala explains why such behavior is covered by case law.

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On March 25, 2020, the German legislator adopted the Law on the Mitigation of the Consequences of the Corona Pandemic in Civil, Insolvency and Criminal Proceedings.[1] The law temporarily forbids the contractual termination of tenancies. If the tenant defaults on a rent payment, the lessor's normal right of termination is suspended until the end of June, provided that the loss of payment is demonstrably due to the Corona pandemic. The tenant is given until mid 2022 to pay off the debt.

Right after the announcement of the law, several large retail chains stated that they would not pay their rent for April 2020 due to the closure of the shops as ordered by the government, although liquid funds would be available for this purpose. This led to heated discussions; in public, this type of behavior has often been seen as lacking solidarity. The Federal Minister of Justice announced that it would be indecent and unacceptable if financially strong companies simply stopped paying their rent. Only if tenants actually ran into serious difficulties paying rent as a result of the crisis could those tenancies not be terminated for a limited period of time.

But is this true? Political assessments need not necessarily be legally sound. Perhaps it is only the sense of justice that sees the lessor here as the party in need of protection and the tenant in the obligation to pay as long as the tenant is not threatened with insolvency. The Austrian General Civil Code (ABGB), which came into force as early as 1812, explicitly addresses the problem of epidemics in tenancy law. Art. 1104, which remains unchanged to this day, states: "If, due to extraordinary circumstances, such as fire, war or epidemic, [...] the object intended to be held cannot be used or put to use at all, the owner of said object is not obliged to restore it, but no rent or lease payment is due."

I. IMPOSSIBILITY OF CONTRACTUAL USE

The Austrian Civil Code (ABGB) does not refer to any risk of insolvency and/or an internal connection between the obligation to pay and the epidemic; however, the simple impossibility of contractual use is sufficient. And on a sobering note, there is also much to be said for this regulation. After all, why should the tenant continue to pay, even though the tenant gets nothing useful in return? And is it not the case in principle that in tenancy law, unlike the law on contracts for the sale of goods or for work and services, the risk of accidental deterioration does not pass to the tenant but to the lessor, as the lessor remains responsible for the fitness for use of the rented property regardless of fault?

Since this is the case, German case law has extended the concept of defects in Section 536 of the German Civil Code (BGB) despite the lack of a statutory provision. The defect can also be recognized as consisting of an external effect on the rental object if this directly affects its practical value. This is (aptly) called an 'environmental deficiency'.

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1 Annelie Kaufmann & Tanja Podolski, *Das steht im Corona-Maßnahmenpaket*, LTO, (Apr. 13, 2020) https://www.lto.de/recht/hintergruende/h/corona-bundesregierung-gesetz-infektionsschutz-strafverfahren-krankenhaus-solo-selbststaendige/.

Recognized examples include construction measures in an adjoining building that force closure of the other building (Federal Court of Justice (BGH), judgement dated April 23, 2008, Case No. XII ZR 62/06) or the blocking of an access area (District Court of Berlin (KG Berlin), judgement dated November 12, 2007, Case No. 8 U 194/06). Indirect impairments, in particular unexpectedly weak customer traffic in shopping malls (Federal Court of Justice (BGH), judgement dated February 16, 2000, Case No. XII ZR 279/97), are irrelevant. In the case of measures ordered by governmental authorities, it is necessary that the measures are directed against the operation and not against the tenant itself (Federal Court of Justice (BGH), judgement dated July 13, 2011, Case No. XII ZR 189/09). All this is fully[2] recognized by the courts, and the discussion is now mainly focused on whether this legal consequence can be limited or waived in the lessor's contractual terms and conditions.

On the basis of this case law, commercial tenants may rightly refuse to pay. This is because the usability has been rendered impossible, as the state has directly intervened against the operation of the business but not against the operator itself. It would be too subtle to argue that the business itself is not prohibited from operating, only customers have been prohibited from entering the business. After all, the shop is rented out as a retail store, so that usability as storage space or for a delivery service is not an argument. And a change of use would also be completely uneconomical, considering the associated rebuilding requirements. More serious is the objection that the current closures do not relate to the leased property but to the business purpose pursued. In particular, grocery stores and bank branches are open regardless of their location, whereas textile and shoe shops are closed regardless of their location, although in the cases decided so far it was precisely the unfavourable location of the shop (next to a construction site, on a closed road, etc.) that led to an 'environmental deficiency' being assumed.

However, it could be countered that this would increase the problem for the tenant, as the tenant cannot escape the current invidious situation by giving notice and changing location. "The 'environment' in the sense of 'environmental deficiency' case law would therefore currently be the entire area affected by the closure. For the time being, we can only wait to see how the case law positions itself in these matters. Nonetheless, the suspension of payment by tenants is not arbitrary or unjustifiable. The case law certainly tends towards the solution of the Austrian Civil Code - no business, no money.

II. PANDEMIC-RELATED RIGHT TO REFUSE PERFORMANCE?

The legislature is, of course, free to regulate the matter differently. And after all, according to the public statements made by the Minister of Justice on television and several members of parliament on Twitter and Facebook, he believes he has already done just that.

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[2] Michael Selk, *Minderung der Gewerbemiete bei behördlich angeordneter Schließung?,* BECK-COMMUNITY (Apr. 13, 2020) https://community.beck.de/2020/03/27/minderung-der-gewerbemiete-bei-behoerdlich-angeordneter-schliessung?fbclid=IwAR160UBCDb4IYMirZiZ6AAOidK80LJ_wIdDrg-vFkFoQcTYGeAkOiVlrj3pg.

This leads to the crucial question: Is the Corona Mitigation Act possibly lex specialis to both Paragraph 536 of the German Civil Code (BGB) and the related case law? Does the law in fact contain no protection for the commercial tenant who could otherwise rely on Paragraph 536 of the German Civil Code (BGB)? Is the tenant therefore actually worse off?
The wording clearly argues against this. The regulation concerning the right to refuse performance in the new Art. 240 of the Introductory Act to the German Civil Code (EGBGB) Section 1[3] expressly does not apply to tenancy law, see there Section 1 Para. 4 No. 1. Furthermore, in the tenancy law regulation on the restriction of termination under Section 2 Para. 1, reference is made to "rent due", and rent that is reduced to zero is not due. However, the preamble to the law is all the more clearly based on the assumption that there is in itself an obligation to continue paying the rent. This is because it expressly states with regard to the restriction on termination: "The obligation of the tenants to pay rent fundamentally remains in place." Furthermore, the law generally shows a desire to support only those who are in economic distress as a result of the pandemic. Art. 240 Section 1 and Section 2 of the Introductory Act to the German Civil Code (EGBGB) both clearly indicate this.

The following is apparently what happened: The Ministry of Justice overlooked Section 536 of the German Civil Code (BGB) and the relevant case law when preparing the draft, and perhaps had residential rent in mind, whereby rooms remain usable. The haste with which the Corona Mitigation Act was passed may have contributed to this. The Ministry of Justice and the Bundestag tacitly assumed that a general right to refuse performance due to a pandemic does not exist and is not wanted by the legislature.
Rather, the law aims to maintain the flow of services as far as possible and to help only those who need help due to the economic situation. The intent of the legislature becomes apparent in that the restriction on termination in tenancy law should remain the only remedy. Therefore, it seems justifiable to put the slightly unfortunate wording behind us as an editorial error due to the haste of the legislative procedure and to help the unspoken intent of the legislature to come forth: A general pandemic-related right to refuse performance is unintentional because it only passes on the liquidity problems to the next person in the performance chain. For the time being, the case law on 'environmental deficiency' also takes a back seat to this. An explicit clarification by the legislature would be helpful, but not absolutely necessary in view of the intent expressed in the Corona Mitigation Act. The obligation to pay remains in force even in times of an epidemic.

III. NEGATIVE PUBLIC REACTION AND BACKTRACKING BY ADIDAS

The strongly hostile reaction of politicians and the public has led Adidas to rethink its position. While at first it was said that the company would only freeze payments to commercial lessors, but would continue making payments to private lessors, on April 1, 2020,

3 Deutscher Bundestag, Entwurf eines Gesetzes zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht (Apr. 13, 2020), http://dip21.bundestag.de/dip21/btd/19/181/1918110.pdf

it was declared that rental payments would be made to all lessors. The realization has now prevailed that a payment freeze could possibly be even more damaging for the company than paying the rent for April 2020. Ultimately, however, the fear of negative customer reactions in the time after the shops reopen and of a loss of image was simply too great for Adidas - regardless of all legal arguments. Other companies that are less well known to the public, such as the shoe chain *Deichmann*, on the other hand, as far as can be seen so far, are sticking to the course they have taken. This is regrettable because the change of course by Adidas is not only in accordance with the intent of the legislature, but also makes economic and moral sense. As individually understandable as it may be to first protect one's own liquidity in an imminent deflationary crisis, this behavior is just as damaging at the macroeconomic level. This is because, with the cessation of rental payments, the economic difficulty shifts to the owner of the property, who must continue to bear operating and financing costs without having any income. If the latter, in turn, is having difficulties making payments, the problem will, in case of doubt, hit the bank that financed the property, and at this point at the latest, as seen in the crisis of 2008, the state will have to step in. A general pandemic payment freeze is therefore a typical policy of the beggar-thy-neighbor: Conserving one's own liquidity reserves is done at the expense of others and therefore ultimately of the general public. It is therefore the right policy of the legislature to not accept such behavior, and the public has also reacted correctly when it criticized the suspension of payments by liquid companies as lacking solidarity. It is to be hoped that this realization will also be accepted by those companies that currently have a different view of the situation.